THE PURPOSE OF FINANCE
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The Purpose of Finance:

What are stock exchanges for and why should we care?

1 Introduction:

Stock exchanges provide a centralised marketplace to enable companies to raise capital from investors and to enable those investors to trade shares in listed companies.

They have played a vital role at the heart of the economy for more than 200 years.

The juggling act they have is to balance the interests of those using the primary markets (raising capital) and secondary markets (trading and price discovery).

Over the past few decades these interests have become increasingly unbalanced.

2 The history of stock exchanges:

The first stock exchange was founded in 1611 in Amsterdam by the Dutch East India Company to help it raise money for its trading voyages to Asia.

The London Stock Exchange has its roots in informal trading in coffee houses in London from the late 17th century.

The New York Stock Exchange opened in 1817.

The business of stock exchanges has been transformed over the past few decades: trading floors have been replaced by computers, and exchanges have converted into fast-growing for-profit technology companies.

3 Stock exchanges help to:

Finance growth and investment
by providing long-term risk capital to companies

Democratise wealth creation
through people's pensions and investments

Drive innovation through
improvements in productivity and long-term economic growth

Set standards for corporate governance
improve transparency and accountability, and support the social licence for business

800bn
the amount of capital raised in real terms by UK companies on the London Stock Exchange over past 25 years

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How do we measure efficiency?

5 The paradox of stock exchanges:

Stock exchanges are bigger than ever before...

6x in real terms

...the value of listed companies in the UK and US has increased... ..over the past 50 years and the value of trading has soared.

Listed companies are becoming bigger and older, they're leaving the market at a faster rate than they can be replaced, and a combination of share buybacks, acquisitions and delistings are sucking valuable equity out of the market.

The number of companies listed on stock exchanges in the UK and US has nearly halved over the past 25 years, and the amount of capital being raised on stock exchanges has fallen by around two thirds.

Without urgent and collective action, this vital tool for raising capital and sharing wealth creation across society could be seriously undermined.

6 What is driving this?

There are three big factors at play:

- The growth of private capital
- The cost and burden of being listed
- Big shifts in the finance industry

7 We think there are three main areas that can be improved:

Rethinking regulation
Regulation can be reviewed and reset to reinvigorate the stock exchange model.

Rethinking exchanges
Exchanges, when viewed through the lens of purpose, have a vital role to play in the future of finance.

Collective action
Exchanges cannot solve this challenge on their own. Listed companies, investors, intermediaries, regulators, policymakers and exchanges themselves can work together in a number of ways to encourage a new approach.

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The third paper in the Purpose of Finance series